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No. 75-354

IN THE

Supreme Court of the United States

October Term, 1975

THE FIRST BOSTON CORPORATION,
Petitioner,

v.

CHRIS-CRAFT INDUSTRIES, INC., *et al.*,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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September 5, 1975

INDEX

PAGE

Opinions Below 1

Jurisdiction 2

Questions Presented 2

Statutes Involved 3

Statement of the Case 3

Reasons for Granting the Writ 8

Conclusion 13

CITATIONS

CASES:

Blue Chip Stamps v. *Manor Drug Stores*, 95 S. Ct. 1917 ..... 7, 8, 9, 10, 11, 13

Ernst & Ernst v. *Hochfelder, cert. granted*, 95 S. Ct. 1557 ..... 10, 11, 12

Mills v. *Electric Auto-Lite Co.*, 396 U.S. 375 ..... 12, 13

Rondeau v. *Mosinee Paper Corp.*, 95 S. Ct. 2069 ... 9, 12

STATUTES:

Section 11 of the Securities Act of 1933, 48 Stat. 82, as amended, 48 Stat. 907, 15 U.S.C. § 77k ..... *passim*

Section 14(e) of the Securities Exchange Act of 1934, 82 Stat. 457, as amended, 84 Stat. 1497, 15 U.S.C. § 78n(e) ..... *passim*

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Petitioner The First Boston Corporation respectfully prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit entered in this proceeding on April 11, 1975.

Opinions Below

The opinion of the Court of Appeals on liability (A1-124)[1] is reported at 480 F.2d 341, and its subsequent opinion on damages (B1-42) is reported at 516 F.2d 172.

[1] The opinions below are reproduced in a separate volume of Joint Appendices A through E submitted with this petition and the petitions of other defendants, and "A", "B", "C", "D" and "E" page references are to that volume.

The opinion of the District Court on liability (A125-162) is reported at 337 F. Supp. 1128, and its opinion on damages (B43-87) is reported at 384 F. Supp. 507.

Prior opinions of the Court of Appeals (C1-31) and the District Court (C32-48) with respect to an application for a preliminary injunction are reported at 426 F.2d 569 and 303 F. Supp. 191, respectively. The opinions of the District Court in the related cases of *SEC* v. *Bangor Punta Corporation* (D1-21) and *Bangor Punta Corporation* v. *Chris-Craft Industries, Inc.* (D22-34) are reported at 331 F.Supp. 1154 and 337 F. Supp. 1147, respectively.

Jurisdiction

The judgment of the Court of Appeals was entered on April 11, 1975 (E1-2), and a timely petition for rehearing was denied on June 9, 1975 (E 4, 8). This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

Questions Presented

Plaintiff, a contestant for control of a corporation, has recovered damages for loss of the contest from the underwriter of a competing exchange offer registered under the Securities Act of 1933, on the claim that an omission in the registration statement was misleading to those who acceped the offer. Plaintiff was not a purchaser of the offered securities.

1. May a contestant for corporate control recover damages from the underwriter of a rival exchange offer under Section 14(e) of the Securities Exchange Act of 1934 on the ground that the underwriter did not discharge

its duty of due diligence under Section 11 of the Securities Act of 1933, even though Section 14(e) has no express provision for civil liability and Section 11 expressly confines the underwriter's liability to purchasers of the offered securities?

2. If so, may the underwriter be held liable for damages (a) far in excess of the limitation on damages expressly prescribed for underwriters by Section 11, and (b) jointly and severally with other defendants held to have committed additional and separate violations of the 1934 Act?

Statutes Involved

Section 14(e) of the Securities Exchange Act of 1934, 82 Stat. 457, as amended, 84 Stat. 1497, 15 U.S.C. § 78n(e), and relevant provisions of Section 11 of the Securities Act of 1933, 48 Stat. 82, as amended, 48 Stat. 907, 15 U.S.C. § 77k, are set forth as an addendum to this petition.

Statement of the Case

This case arises out of a contest between Chris-Craft Industries, Inc. ("Chris-Craft") and Bangor Punta Corporation ("Bangor Punta") for control of Piper Aircraft Corporation ("Piper"). Bangor Punta was the apparent victor, acquiring about 51% of Piper's shares, including about 7% through an exchange offer of its own securities for stock of Piper (A131, D3). First Boston acted as dealer-manager for Bangor Punta's exchange offer, registered under the Securities Act of 1933, for which it received a fee of $40,000.

This action, brought by Chris-Craft against Bangor Punta, First Boston and others,[2] and related actions, brought by Bangor Punta and the SEC, were tried concurrently. The District Court dismissed all the claims of each of the contestants (A125-162, D22-34), but held that the SEC was entitled to equitable relief against Bangor Punta (D1-21) because the registration statement on the exchange offer had omitted mention of a material fact (D12-15).[3]

Although the District Court found no "improper purpose" or "bad faith" in the omission, it held (a holding not contested by this petition) that good faith was not a defense to an action by the SEC seeking equitable relief. The court ordered Bangor Punta to make a rescission offer to the Piper shareholders who had accepted the exchange offer (D16).[4]

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[2] Jurisdiction was based on 28 U.S.C. § 1331(a), 15 U.S.C. § 78aa, and 15 U.S.C. § 77v.

[3] The omission was that Bangor Punta had received and considered an offer to purchase one of its assets (the Bangor and Aroostook Railroad, known as the "BAR") for $5,000,000, which was $13,000,000 less than its carrying value on Bangor Punta's books (D12-15). In fact, upon announcement of the sale three months after the registration statement became effective, in a much less advantageous form from a tax standpoint than had earlier been considered, the market price of Bangor Punta stock went up. (Printed Appendix in the Court of Appeals, vol. 2, at 591a.)

[4] The relief granted by the District Court was directed solely to vindication of the public policy embodied in the securities laws, and not to redress of any economic loss suffered by the tendering shareholders, since none existed (D16).

Chris-Craft was denied relief on all of its claims (A161) on the ground that it had failed to establish the essential elements of a claim for damages under the Securities Exchange Act of 1934, including scienter and causation (A144). The court further said with respect to First Boston that, even had the record supported the claims against the other defendants, "the Court would be hard put to find any basis for extending liability to the First Boston defendants," who had "acted solely" in "good faith" (A158-159).

On appeal, the Court of Appeals set aside none of the District Court's findings (A7 & n. 1), but held that Chris-Craft, although not a purchaser of any Bangor Punta securities, was a "victim" of the alleged violations of Section 14(e) of the 1934 Act. The court said that because Chris-Craft "got less stock than it needed for control" of Piper, it had, without any proof of causation in fact, "a right of action for damages against all defendants" (A31-33).

First Boston, the Court of Appeals held, was liable to Chris-Craft under Section 14(e) of the 1934 Act because it "did not adequately perform its duty" to make a "reasonable investigation" as an underwriter under Section 11 of the Securities Act of 1933 (A51). The court repeatedly referred to First Boston as an "underwriter" (A48-51), a term that appears nowhere in the 1934 Act, without making any analysis of how First Boston's duty, if any, under the 1934 Act to Chris-Craft or others who were not purchasers of the registered securities differed in kind or degree from its duty to purchasers under the 1933 Act.

The Court of Appeals also held the other defendants liable for separate and additional violations of Sections 10(b) and 14(e) of the 1934 Act involving allegedly improper cash purchases of Piper shares by Bangor Punta and allegedly misleading statements to shareholders by members of the Piper family (A37-43, 63-67). Although First Boston was not held responsible for either of these violations, the court directed entry of a judgment "assessing damages against all defendants jointly and severally" (A69). Damages were to be measured, again without proof of cause and effect, by "the reduction in the appraisal value of [Chris-Craft's] Piper holdings attributable to [Bangor Punta's] taking a majority position and reducing [Chris-Craft] to a minority position, and thus being able to compel a merger at any time" (A69).[5]

On remand, the District Court found that "the reduction in the appraisal value" of Chris-Craft's shareholding in Piper was "generously valued" at $2.40 per share, or a total of $1,673,988 (B70). The court also allowed Chris-Craft prejudgment interest on that amount (B76-79).

On further appeal by Chris-Craft, the Court of Appeals again reversed, saying that by "reduction in appraisal value" it meant the difference between what Chris-Craft had paid for its Piper shares ($64 per share) (B25) and

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[5] The Court of Appeals also granted injunctive relief against Bangor Punta precluding it from voting its "illegally" obtained shares for five years, and affirmed the dismissal of Bangor Punta's claims against Chris-Craft and the grant of equitable relief to the SEC, with modifications not relevant to this petition. Petitions for certiorari were denied, 414 U.S. 910.

the price at which, had it wished to do so, it could have sold its shares five months after Bangor Punta had acquired control (B28-31). There had been a drastic general decline in the securities markets during this five-month period, and the court fixed the hypothetical sales price at $27 per share (B29-31).

On this basis, the court awarded Chris-Craft damages of $25,793,365 (B31). It also "affirmed" the District Court on the award of prejudgment interest (B32-34). The total award of damages against First Boston, jointly and severally, is thus over $35,000,000, or more than four times the limitation on its liability as an underwriter expressly prescribed by Section 11 of the 1933 Act, i.e., the total price of the registered securities, about $8,000,000.

First Boston petitioned for rehearing or rehearing in banc, questioning the court's measure of damages and particularly its holding First Boston liable jointly and severally for an amount far in excess of the Section 11 limitation. The SEC, which had filed *amicus curiae* briefs supporting Chris-Craft's positions on various points throughout this litigation, supported First Boston's position with respect to the damage limitation of Section 11 and also urged the court to consider carefully the appropriateness of joint and several liability.

Rehearing was denied on June 9, 1975, the day this Court announced its decision in *Blue Chip Stamps* v. *Manor Drug Stores*, 95 S. Ct. 1917.

Reasons for Granting the Writ

The decision below—holding that a violation of Section 11 of the 1933 Act gives rise to an *implied* right of action under Section 14(e) of the 1934 Act in favor of persons, and for an amount, beyond the *express* limitations on liability fixed by Section 11—is contrary to principles enunciated by this Court and raises issues of public importance.

I.

As the SEC stated to the Court of Appeals in its memorandum *amicus curiae* in support of First Boston's petition for rehearing, the questions raised by the damage award against First Boston may have "a wide-ranging impact upon the investment banking industry, upon the nation's economy and upon the enforcement of the federal securities laws by the Commission as well as by private parties."

In holding against First Boston, the Court of Appeals expanded the duty of due diligence of an underwriter far beyond the bounds set by Congress in Section 11 of the 1933 Act and imposed upon an underwriter, for the first time since passage of the Act, liability in favor of a party which never purchased the registered security and liability for damages exceeding the maximum permitted by Section 11.

The court also necessarily determined a question corresponding to that expressly reserved by this Court in *Blue Chip Stamps* v. *Manor Drug Stores, supra* at 1933 n. 15: whether an implied action under the 1934 Act "will lie for actions made a violation of the 1933 Act and the subject of express civil remedies under the 1933 Act."

The issues determined below will come before the courts on a recurring basis, since virtually all contests for

corporate control involve litigation by the contestants against one another and their respective officers, investment bankers and other advisors. It is noteworthy in this connection that Congress in passing the Williams Act, which added Section 14(e) to the 1934 Act, did not intend to create a legal regime that would "discourage takeover bids." *Rondeau* v. *Mosinee Paper Corp.*, 95 S. Ct. 2069, 2076.

It is important to the public interest in properly functioning capital markets and to the administration of the securities laws as a whole that the Court consider and determine the questions presented.

II.

First Boston was held liable for a failure properly to perform the duty imposed upon it as an underwriter by Section 11 of the 1933 Act. But "§ 11(a) of the 1933 Act confines the cause of action it grants to 'any person acquiring the security' " (*Blue Chip Stamps* v. *Manor Drug Stores, supra* at 1925) and Chris-Craft acquired no securities underwritten by First Boston.

The result reached below as to First Boston is thus directly contrary to this Court's reasoning in *Blue Chip Stamps, supra* at 1925-26, where it said, "It would indeed be anomalous to impute to Congress an intention to expand the plaintiff class for a judicially implied cause of action beyond the bounds it delineated for comparable express causes of action."

The present case differs (insofar as the basis of this petition is concerned) only in that the judicially implied liability under the 1934 Act that clashes with Section 11

of the 1933 Act arises not under Section 10(b) but under the parallel provisions of Section 14(e).[6]

Indeed, the decision below contravenes the principles of *Blue Chip Stamps* in three respects: (1) by expanding the class to whom an underwriter is liable, (2) by expanding the underwriter's statutory exposure to damages, and (3) by making the underwriter liable for other violations by other defendants for which it bore no responsibility. The decision below has thus done no less than nullify the express limitations of private actions prescribed by Section 11 of the 1933 Act as far as First Boston is concerned.

III.

As originally enacted, 48 Stat. 82, Section 11 of the 1933 Act imposed upon underwriters both the duty of due diligence with respect to the content of registration statements and a broad "rescission" measure of damages such as that adopted by the Court of Appeals here. After brief experience, however, Congress found that the exposure to liability created by the statute had caused a substantial disrup-

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[6] In another case under Section 10(b), *Ernst & Ernst* v. *Hochfelder*, *cert. granted*, 95 S. Ct. 1557, the SEC, at pages 8 and 9 of its brief as *amicus curiae*, argues, in language equally applicable to Section 14(e):

> "The private right of action to recover damages for violation of Rule 10b-5 is a judicially created remedy, designed to further the purposes of the federal securities laws. In determining whether damages should be awarded for a particular violation of Rule 10b-5, the limitations upon damage liability that Congress imposed in those sections of the federal securities laws that expressly provide for private damage suits for violations of those laws constitute an appropriate guideline for the courts in determining the scope of the implied action under Rule 10b-5."

tion in the capital formation process and, as a part of the 1934 Act itself, amended Section 11, 48 Stat. 907, to limit the damages recoverable in two significant respects:

> (1) Damages may not include any diminution in the value of securities "other than the depreciation . . . resulting from" the particular omission or misstatement.
>
> (2) The liability of an *underwriter* is limited to the "total price at which the securities underwritten by him and distributed to the public were offered to the public."

These amendments embody a deliberate policy decision by Congress, and were characterized by Senator Fletcher, in introducing them on the floor of the Senate, as "the most important of all" the amendments to the 1933 Act adopted with passage of the 1934 Act. *See Blue Chip Stamps* v. *Manor Drug Stores, supra* at 1927-28.

The damages awarded to Chris-Craft by the Court of Appeals were for "loss" in the market value of a security other than the registered security—indeed, a security of a different issuer—that was caused in large part by a general market decline, and not in any sense "resulting from" the error in the registration statement. The award of $35,000,000 also totals over *four times* the total price of the securities underwritten by First Boston. In both respects, the Court of Appeals' decision is in clear conflict with an express determination of Congress as recognized by this Court. See *ibid.*[7]

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[7] Again, the SEC aptly argues at page 24 of its brief in *Ernst & Ernst, supra:*

> "Since the theory of the implied private right of action under the federal securities laws is that it is necessary to effectuate the congressional standards for the conduct of securities transactions, the standards Congress adopted when it expressly created private actions under those laws are an appropriate guideline in defining the contours and conditions of the judicially-created right of action."

First Boston was also held liable "jointly and severally" for these huge and speculative damages, despite the fact that its liability stems only from the registration statement and from but one of several violations held to have caused the damage. In view of First Boston's limited and secondary role, joint and several liability for the whole of this award—over 900 times its fee and half its net worth—is unreasonable and completely disproportionate to the wrong it was found to have done, as well as contrary to law.

IV.

In granting recovery to Chris-Craft, the decision below also seriously misapplied *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375. In *Mills* the Court held that causation of injury to public shareholders necessarily existed where there was a material omission from a proxy statement for a corporate merger. The Court emphasized, however, that the nature of the relief must be based on proof of actual damages, if any, and the equities of the particular case. *See Rondeau* v. *Mosinee Paper Corp.*, 95 S. Ct. 2069; *see also* Brief for the SEC as Amicus Curiae, *Ernst & Ernst* v. *Hochfelder*, No. 74-1042, at 23-32.

Here, the Court of Appeals used *Mills* in the entirely different context of a huge damage action by a party that in no sense relied on a registration statement to establish as a matter of law both the fact of injury and the causal nexus between an omission from the registration statement and the claimed damages.

Such a departure from basic tort principles requiring proof of causation in fact is in no way supported by *Mills*,

as was recognized by the District Court in this case. Rightly rejecting Chris-Craft's reliance on *Mills*, the District Court noted that Chris-Craft was not a purchaser on the registration statement but was "seeking to recover because of the effect which a misstatement allegedly had on third parties" (A145).

By taking a contrary approach and dispensing with proof of causation, the decision of the Court of Appeals both misconstrues *Mills* and is inconsistent with the disapproval in *Blue Chip Stamps, supra* at 1925, of "conjectural and speculative recovery" of damages in implied actions under the 1934 Act.

Conclusion

For the foregoing reasons, a writ of certiorari should issue to the United States Court of Appeals for the Second Circuit.

Respectfully submitted,

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Addendum

Text of Statutes Involved

Section 14(e) of the Securities Exchange Act of 1934, 82 Stat. 457, as amended, 84 Stat. 1497, 15 U.S.C. § 78n(e), provides:

"(e) It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation. The Commission shall, for the purposes of this subsection, by rules and regulations define, and prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, deceptive, or manipulative."

In relevant part, Section 11 of the Securities Act of 1933, 48 Stat. 82, as amended, 48 Stat. 907, 15 U.S.C. § 77k, provides:

"(a) In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may, either at law or in equity, in any court of competent jurisdiction, sue—

* * *

(5) every underwriter with respect to such security.

* * *

(b) Notwithstanding the provisions of subsection (a) no person, other than the issuer, shall be liable as provided therein who shall sustain the burden of proof—

* * *

(3) that (A) as regards any part of the registration statement not purporting to be made on the authority of an expert . . . he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading . . .

(c) In determining, for the purpose of paragraph (3) of subsection (b) of this section, what constitutes reasonable investigation and reasonable ground for belief, the standard of reasonableness shall be that required of a prudent man in the management of his own property.

* * *

(e) The suit authorized under subsection (a) may be to recover such damages as shall represent the difference between the amount paid for the security (not exceeding the price at which the security was offered to the public) and (1) the value thereof as of the time such suit was brought, or (2) the price at which such security shall have been disposed of in the market before suit, or (3) the price at which such security shall have been disposed of after suit but before judgment if such damages shall be less than the damages representing the difference between the

amount paid for the security (not exceeding the price at which the security was offered to the public) and the value thereof as of the time such suit was brought: Provided, that if the defendant proves that any portion or all of such damages represents other than the depreciation in value of such security resulting from such part of the registration statement, with respect to which his liability is asserted, not being true or omitting to state a material fact required to be stated therein or necessary to make the statements therein not misleading, such portion of or all such damages shall not be recoverable. In no event shall any underwriter (unless such underwriter shall have knowingly received from the issuer for acting as an underwriter some benefit, directly or indirectly, in which all other underwriters similarly situated did not share in proportion to their respective interests in the underwriting) be liable in any suit or as a consequence of suits authorized under subsection (a) for damages in excess of the total price at which the securities underwritten by him and distributed to the public were offered to the public."